Employee Benefits Report

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Health May 2021 Volume 19 • Number 5

COBRA and DCAP Recipients Get Help from $1.9 Trillion American Rescue Plan Act

The American Rescue Plan Act of 2021 includes significant, temporary COBRA and DCAP changes

The American Rescue Plan Act of 2021 (ARPA), the $1.9 trillion COVID-19 relief package, signed into law by President Joe Biden in March, includes significant, temporary subsidies to the Consolidated Omnibus Budget Reconciliation Act (COBRA). It also includes a temporary increase in the maximum amount which can be excluded from income under dependent care assistance programs (DCAPs).

These changes mean additional responsibilities for employers in 2021.

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IRS Relaxes FSA Guidelines During COVID

The Internal Revenue Service (IRS) has released additional guidance for the COVID-related Taxpayer Certainty and Disaster Tax Relief Act of 2020. Notice 2021-15 allows employers who offer flexible spending arrangements (FSA) to adjust their programs in 2021 and 2022 to help employees meet unanticipated consequences of the public health emergency.

An FSA is a savings account that employers can set up for employees. Typically, employees set aside a certain amount of pre-tax wages to pay for qualified medical, vision and dental expenses. A second kind of FSA can be used

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COBRA

Employers who had 20 or more employees in the previous year must offer qualified employees and their families the opportunity to keep their group health benefits for a limited time. Qualifying circumstances include voluntary or involuntary job loss; reduction in hours; transitioning between jobs; death; divorce; and other life events.

Currently under COBRA, employees who are losing their jobs must pay the entire premium up to 102 percent of the cost to the plan sponsor. The new law features a 100 percent subsidy to pay COBRA premiums for certain Assistance Eligible Individuals (AEI). The federal government will use employer payroll tax credits to pay the subsidies. The premium subsidies began April 1, 2021 and will end on Sept. 30, 2021. All group health plans subject to COBRA, other than health flexible spending accounts (i.e., medical, dental, and vision), must provide the subsidy.

Employees who did not reduce their hours or leave their job voluntarily are eligible for the subsidy, while employees who voluntarily terminated their employment are not.

There is a time limit on the subsidy. Employees can get the subsidy for up to six months. Eligibility ends when one of these conditions is met:

- When the former employee's maximum period of COBRA coverage ends.
- On Sept. 30, 2021 — the last day of the program.
- If the former employee becomes eligible for coverage under another group health plan or Medicare. COBRA recipients must notify their former employer if they become eligible for other coverage or pay a penalty ($250 or 110% of the subsidy amount, whichever is more).

Employers should be prepared for the extra administrative work involved with subsidized COBRA premiums, which should be done in coordination with third-party administrators or COBRA administrators. Be sure to:

- Determine who may be eligible for the subsidy. This would include individuals who were COBRA eligible for the last 18 months. For instance, someone whose employment was terminated or whose hours were reduced in November 2019 would qualify for the subsidy since their 18-month eligibility would run through April 2021.
- Provide a revised COBRA notice to anyone who may be eligible for the subsidy. This will require employers to amend their current COBRA notice and election forms. The Department of Labor can provide a model notice to help ensure notices are issued correctly.
- Make sure COBRA premiums are not collected from COBRA recipients during the subsidy period.

Employers also are responsible for sending a notice between 45 and 15 days before the date an individual's subsidy will expire. No notice needs to be sent if the subsidy is expiring because the individual has become eligible for coverage under another group health plan or Medicare.

Employers may offer AEIs a different coverage option — provided it is also offered to active employees and doesn't cost more.

Although employers or insurers will pay 100% of the COBRA premium during the subsidy period, the federal government will provide reimbursement if they claim a cor-

to pay for childcare expenses or for adults who cannot take care of themselves. Any funds in the account not spent by the employee within the plan year are usually forfeited, or if the plan allows, up to $550 in the Health FSA may be allowed to rollover to the next year.

Notice 2021-15 provides flexibility for employers to:

- **Allow employees to carry over any unused amounts from the 2020 and 2021 plan years**
- **Extend the permissible period for incurring claims for plan years ending in 2020 and 2021**
- **Adopt a special rule regarding post-termination reimbursements from health FSAs**
- **Allow a special claims period and carryover rule for dependent care assistance programs when a dependent "ages out" during the COVID-19 emergency**
- **Allow mid-year election changes for health FSAs and dependent care assistance programs for plan years ending in 2021.**

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responding credit against their Medicare payroll tax liability.

DCAP Provisions

A Dependent Care Assistance Program (DCAP) allows employees to get a tax break when they pay certain care expenses on behalf of qualifying dependents — children, a disabled spouse, or legally dependent parents.

For 2021 only, ARPA increases the maximum DCAP benefits that can be excluded from income from $5,000 to $10,500 ($2,500 to $5,250 for married people filing separately). Employers may retroactively amend their DCAP plan no later than the last day of the plan year in which the amendment is effective, provided the plan follows its amended terms from the beginning of its effective date.

For more information about the American Rescue Plan, talk to your broker or visit www.congress.gov/117/bills/hr1319/BILLS-117hr1319enr.pdf. ■

Does an ESOP Make Sense for Your Company?

Looking for ways to supplement your company's 401(k) retirement plan? Want to reward employees who helped build your business? Looking for ways to facilitate succession planning?

For some firms, an Employee Stock Ownership Plan (ESOP) could be an option.

An ESOP is an employee benefit plan that gives workers ownership interest in the company. The selling shareholder, as well as the participants in the plan, receive various tax benefits.

Companies often use ESOPs to align the interests of their employees with those of shareholders. The concept implies that plan participants will do what is best for shareholders, since the participants themselves are shareholders.

An ESOP is also a way to establish a transition plan by creating a market for the company's stock. This way the company can sell the business gradually instead of exiting suddenly, even as it establishes an ownership culture within the company.

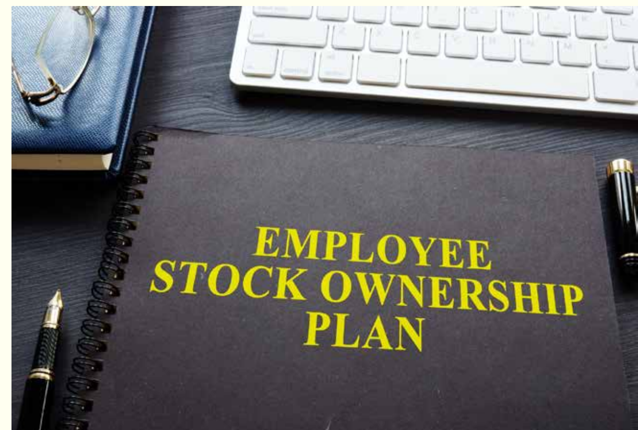
A company can sell stock to employees by:

- Giving them shares as a bonus.
- Allowing them to receive stock options.
- Paying dividends in stock through a profit-sharing plan
- Allowing them to buy company stock directly through ESOPs.

Tax Advantages to Starting an ESOP

Both plan participants and the company can get tax deductions with an ESOP.

When the ESOP borrows money to buy shares, the company can make tax-deductible contributions to the plan to repay the loan. Contributions to repay principal are deductible up to 25 percent of the plan participants' payroll; however, interest is always deductible.



ESOPs don't pay federal income tax, and employees don't pay income tax on stock put into their ESOP accounts until they take distributions. However, they will have to pay a 10 percent penalty in addition to the income tax if they take a distribution prior to age 59 ½. They can avoid that penalty and defer taxes if they roll the money into an IRA or another qualified plan.

Employers who own a C-corporation and sell 30 percent or more of their stock to the ESOP can defer — or maybe avoid — the capital gains tax. How-

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ever, the sales proceeds must be reinvested into stocks, bonds, or other securities of U.S. operating companies — but not into government bonds or mutual funds.

How to Start an ESOP

It's critical to do a valuation before implementing a plan. Plus, a feasibility study will be needed if there is any doubt about the ESOP's ability to repay the loan. An analysis can reveal how much extra cash flow the company has available to devote to the ESOP and whether it's adequate. Employers must also consider the effect of other benefit plans on cash flow. And lastly, there should be an estimate of what it would cost to repurchase stock.

An employer should establish a trust to buy stock. The ESOP trust will own the stock and allocate shares to individual employee's accounts.

A trustee must be chosen to oversee the plan. This can be someone from within the firm, but some private and most public companies hire an outside trustee.

Usually, all full-time employees age 21 and over have the option of participating in the plan. Allocations are usually based on an employee's pay. Plus, as employees accumulate seniority, their right to exercise the full privilege of the shares in their account increases; a process known as vesting. Employees must be 100 percent vested within three to six years.

Employees get the stock after they leave the company, so the company must offer to buy the shares back unless there is a public market for them.

Drawbacks to an ESOP

The cost of setting up even a simple ESOP could be as much as $40,000 or more. Another cost to keep in mind is that any time a company issues new shares, the stock of existing owners is diluted. Plus, private companies must repurchase a departing employee's shares, which could represent a major expense if a large number of workers all quit or retire at the same time.

The ESOP must pay no more than fair market value for company shares; so, as a transition plan, the principals of the employer will probably make more money by selling the company outright or taking it public.

Also, employers can only use an ESOP in C- or S-corporations, not partnerships or most professional corporations. ■

How Carve-Outs Lower Health Plan Costs

Employers who self-fund or level fund their health coverage benefits can lower their costs by working with third-party contractors to manage aspects of their plan using a practice called carve-outs.

A carve-out allows self-insuring employers to isolate specific risks within the scope of health insurance coverages they provide. The third-party vendor assumes financial risk for the carve-outs for which it receives a flat fee from the employer. A carve-out can include the majority of a plan or just a single benefit such as pharmacy or addiction services.

In addition to reducing the costs of providing employee health coverage, employers also use carve-outs to:

- Ensure consistent access to medical care
- Provide comprehensive health care, and
- Minimize bureaucracy.

Carve-out areas typically include products that may be considered too costly under a regular group policy, such as:

- Prescription drug benefits
- Drug and alcohol addiction services
- Mental illness screening, diagnosis and treatment benefits
- Burn units
- Cardiac care
- Trauma
- Visual services
- Dental services
- Neonatal intensive care
- Organ transplant

Carve-outs are often a good fit for large, self-funded employers. These entities, because of their large group size, can access a wider selection of vendors and leverage their size to negotiate better rates. Large employers also usually have the internal

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resources to manage multiple insurance vendors and to educate employees on which vendor to use. Mid-sized employers typically rely on an experienced insurance broker for assistance or an outside administrator to provide risk management services.

Advantages

The most obvious advantage of a carve out is the ability to offer better options and manage costs better through experienced vendors. For instance, the cost of drugs is a major expense and a company acting alone can incur serious financial debt if an employee is prescribed an expensive drug. With a carve-out, a third-party vendor may assume the financial risk to provide the coverage in exchange for a negotiated flat fee.

Carve-outs are appealing because they lock in a fixed price, enabling managers to better predict plan expenses. They also remove volatile areas of care from the plan.

Employees often appreciate carve-outs because it means their plan provides high quality care for people with specialty pharmacy requirements, behavioral health challenges and chronic illnesses.

Disadvantages

The administration of your group health plan can be challenging to coordinate — depending on how many vendors you add. For instance, you will need to draft multiple pharmacy and medical contracts since you will often be dealing with more than one vendor for different products. This can place an additional administrative burden on your human resources department.

Other risks include:

- Problems with legal recourse and first-loss coverage. When filing a claim, the issue of first loss must often be dealt with. “First loss” is when someone carries multiple policies for an illness or injury. Who is responsible for “first loss” must be determined and paid by one or the other providers or apportioned among multiple parties (it can get complicated).
- The possibility that the health insurance company will fail to meet its obligations.
- Third-party provider’s performance may not meet your requirements.

Carve-outs also require more employee education since participants may need to go to different vendors for different services.

And, while carve-outs can reduce specific risks, they never will reduce the overall risk to the company’s plan. Please contact us for more information.

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IRS Waives Taxes on Donated PTO

The U.S. Internal Revenue Service (IRS) has special rules for leave-sharing during natural disasters.

The IRS considers COVID-19 as a major disaster. It posted a set of frequently asked questions (IRS Notice 2006-59) regarding the tax treatment of leave-sharing plans maintained by an employer to help its COVID-19 affected employees.

If you have a leave-sharing program your employees will not have to pay taxes on any paid time off (PTO) they give to fellow employees during the COVID-19 pandemic.

Leave-sharing programs allow employees to donate their PTO (vacation or sick leave) to a general pool to be used by other employees. Employees who qualify for using donated PTO have experienced medical emergencies or were affected by major disasters causing them to exhaust all paid leave available to them.

Usually, when an employee donates leave time, the IRS treats it as W-2 compensation and employees must pay income and employment tax on the donated leave time.

The IRS allows exceptions for major disasters, however, such as a hurricane or virus. In such cases, employees who donate leave will not be taxed on the donated leave time.

For employees to take advantage of this exception, employers must sponsor and make available a “major disaster leave-sharing plan”. The main requirements of the plan:

- Donations are to be made to a “bank” for those who have been adversely affected by a major disaster and not to a specific recipient.
- Donors can’t donate more time than they have accrued.

- A time limit for donating and using the time must be established.
- Recipients may not convert leave into cash.
- Recipients may use leave to eliminate a negative leave balance they accrued because of the disaster.
- The employer will determine how much leave each recipient may receive.

Employers do not have to submit reports to the IRS since this plan is not subject to ERISA regulations.

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